No. 10,220

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

MOUNT TIVY WINERY, INC. (a corporation), *Appellant,*

vs.

JOHN V. LEWIS, Collector of Internal Revenue, First California District, and UNITED STATES OF AMERICA, *Appellees.*

CALIFORNIA WINERIES AND DISTILLERIES, INC. (a corporation), *Appellant,*

vs.

JOHN V. LEWIS, Collector of Internal Revenue, First California District, and UNITED STATES OF AMERICA, *Appellees.*

FRESNO WINERY, INC. (a corporation), *Appellant,*

vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al., *Appellees.*

SANTA LUCIA WINERIES, INC. (a corporation), *Appellant,*

vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al., *Appellees.*

CHARLES DUBBS and SAMUEL CAPLAN, Co-partners doing business as ALTA WINERY AND DISTILLERY, *Appellants,*

vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al., *Appellees.*

CALIFORNIA GROWERS WINERIES, INC. (a corporation), *Appellant,*

vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al., *Appellees.*

ST. GEORGE WINERY (a corporation), *Appellant,*

vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al., *Appellees.*

On Appeals from the District Court of the United States for the Northern District of California.

BRIEF FOR APPELLEES.

FILED

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OPINION BELOW.

The opinion of the District Court (R. 37-47) is reported at 42 F. Supp. 636.

JURISDICTION.

The appeal[1] in *Mount Tivy Winery v. Lewis* is taken from a judgment of the District Court entered April 3, 1942 (R. 85-86), in favor of the appellee in an action filed on August 28, 1938 (R. 2-10), pursuant to the provisions of Section 24, Fifth, of the Judicial Code, for the refund of $15,419.33 assessed and paid as taxes imposed on wine held by a producer under Section 10(c) of the Liquor Taxing Act of 1934. A claim for refund was filed on August 28, 1935 (R. 33) within four years after date of payment and was rejected by the Commissioner of Internal Revenue on July 29, 1936. (R. 33.) The notice of appeal was filed on July 3, 1942 (R. 90-93), pursuant to Section 128(a) of the Judicial Code, as amended.

QUESTIONS PRESENTED.

1. Whether the taxpayer, the producer of the wine here involved, held such wine on January 12, 1934, within the meaning of Section 10(c) of the Liquor

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[1]Upon stipulation of the parties (R. 94-97), and order of the District Court (R. 98), the appeals in the other six cases have been consolidated for all purposes with the *Mount Tivy Winery* case and are to be governed by the decision in that case. The judgments of the District Court in these other cases, as well as notices of appeals, were filed on the same dates as in the *Mount Tivy Winery* case, and these cases meet all of the jurisdictional requirements.

Taxing Act of 1934 and so is liable for the tax imposed by such section.

2. Whether the tax imposed by Section 10(c) of the Liquor Taxing Act of 1934 is a valid excise tax, as the District Court held, or whether it is unconstitutional, as the taxpayer claims.

STATUTE AND OTHER AUTHORITIES INVOLVED.

The pertinent statute and other authorities involved are set forth in the Appendix, *infra,* pp. i-iv.

STATEMENT.

The facts as found by the District Court in *Mount Tivy Winery v. Lewis*[2] may be summarized as follows (R. 48-81):

This is an action against a former Collector of Internal Revenue to recover $15,419.33 in taxes and interest alleged to have been erroneously collected. The taxpayer is a California corporation, with its principal place of business at Fresno, California. It is engaged in the manufacture, production and sale of wine intended for sale or use in the manufacture of articles intended for sale in Bonded Winery No. 3620 at Lac-Jac, Fresno County, California. (R. 48-49.)

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[2]As the facts in all seven cases are very similar and as it has been stipulated by the parties that these cases, which have been consolidated for all purposes, will be controlled by the decision in the *Mount Tivy Winery* case, the facts in the other cases have not been given in the record. (R. 94-98.)

On November 13, 1933, the taxpayer and the Fidelity Warehouse Corporation executed a "Field Warehouse Storage Agreement", which provided among other things that the Fidelity Warehouse Corporation should furnish the taxpayer all field warehouse services necessary to the taxpayer's business and that the taxpayer should employ the Fidelity Warehouse Corporation for all field warehouse services required by the taxpayer and further, that the taxpayer would furnish warehouse premises owned or controlled by the taxpayer in which field warehousing was to be conducted. Specifically, the Fidelity Warehouse Corporation agreed among other things (1) to maintain a public warehouse in and upon premises leased by the taxpayer to the corporation; (2) to furnish to the taxpayer all field warehouse services necessary to the taxpayer's business; (3) to place a bonded agent and/or bonded watchman in charge of the warehouse and leased premises; and (4) to issue field warehouse receipts upon the property which the taxpayer might store therein. The agreement also provided (1) that the Fidelity Warehouse Corporation should be free from all liability for taxes or penalties levied, assessed by a federal or any other governmental or quasi-public agency in respect to the wines warehoused under the terms of the agreement; (2) that the taxpayer agreed to render all required reports in respect to the commodities warehoused by any and all governmental agencies; and (3) that at the option of the Fidelity Warehouse Corporation it could pay all taxes, penalties, and could service, blend, fortify, rectify, handle and care for the warehoused wines and could render

all reports at the expense of the taxpayer in the event the taxpayer failed to do so as agreed in the agreement. (R. 49-51.)

On the same date, the taxpayer executed a Field Warehouse Lease, pursuant to the provisions of the Field Warehouse Storage Agreement and as authorized by Treasury Decision 19. This leased to the Fidelity Warehouse Corporation a portion of a building and all containers therein for use as a warehouse. The building so leased was adjacent to the same premises as taxpayer's Bonded Winery No. 3620, bore the same postoffice box number and was contiguous with and adjoining the structures of taxpayer's Bonded Winery No. 3620. (R. 51.)

On November 25, 1933, the Fidelity Warehouse Corporation secured a permit to establish and operate Public Bonded Storeroom No. 3728 in the leased premises. (R. 51, 58.) Such permit was issued pursuant to the federal and state laws and the regulations thereunder, particularly Treasury Decision 19 and General Circular No. 141, approved September 16, 1933.[3] This circular announced amendments to the regulation, which provided (1) that all proprietors of bonded wineries must secure permits in order to operate, but field warehouses could be established by others than winemakers for the storage of wine for credit purposes, when in the Commissioner's judgment such warehouses were warranted; (2) that anyone advanc-

[3]These were introduced as Exhibit A, attached to the stipulation (R. 16, 34), and are not included in the record, but copies have been transmitted to this Court pursuant to a stipulation of the parties (R. 100-102; for excerpts, see also R. 52-57).

ing credit on the security of the wine stored in the warehouse could dispose of such wine, upon foreclosure, only to a permit holder; (3) that warehouse receipts covering the wine were only transferable to a permit holder; and (4) that warehouse receipts must state the above provisions in (1) and (2) on their face. (R. 52-53.) An opinion of the Attorney General held that such provisions were valid. (R. 54-57.)

The leased premises were taken over by the Fidelity Warehouse Corporation, and a bonded agent was placed in charge and given printed instructions as to his duties. The warehouse agreement and lease were executed prior to the passage of Section 10(c) of the Liquor Taxing Act of 1934, here involved, and were not executed in contemplation of such statutory provision. (R. 59.)

During the months of November and December, 1933, and before January 12, 1934, taxpayer removed 484,000 gallons of fortified wines from Bonded Winery No. 3620 and stored it in Public Bonded Storeroom No. 3728, and in writing requested the Fidelity Warehouse Corporation to issue four original wine warehouse receipts negotiable in form, for a total of 484,000 gallons of wine to the Bank of America National Trust & Savings Association, Fresno Branch, or order (hereinafter referred to as the Bank) as follows: One for 211,000 gallons dated November 29, 1933, numbered 01304; the second for 123,000 gallons dated December 4, 1933, numbered 01307; the third for 119,000 gallons dated December 22, 1933, numbered 01312; and the fourth for 31,000 gallons dated January 6, 1934, num-

bered 01316; which receipts were issued and executed in the name of and were delivered at the request of the taxpayer on those dates to the Bank by the Fidelity Warehouse Corporation. (R. 59-60.)

The warehouse receipts were marked negotiable and stated that the Fidelity Warehouse Corporation had received for storage from the Mount Tivy Winery, deliverable to the Bank or order, the property described therein, subject to the conditions contained therein and the payment of storage and other charges. (R. 60.) The receipt also provided (R. 61, 62):

> This Fidelity Warehouse Company warehouse receipt is issued pursuant to permit No. P-18, issued by the Bureau of Industrial Alcohol, United States Treasury Department, in accordance with section 704 of the Regulations 2 and Paragraph 9 of Regulations 7, as amended, which authorized the issuance of this warehouse receipt.[4]
>
> * * *
>
> These goods will be delivered upon surrender of this receipt, properly endorsed, and the payment of all charges and liabilities due the undersigned warehouseman.
>
> The Wine Covered by This Warehouse Receipt Cannot Be Possessed, or Used in any Manner or Disposed of or Transferred Except to a Bona Fide Permittee of the Bureau of Industrial Alcohol.

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[4]These regulations provided for field warehouses, such as the one here, for credit purposes (R. 52-53), and Permit No. P-18, which is Exhibit C herein, authorized the Fidelity Warehouse Corporation to establish and operate a bonded storeroom "for credit purposes", as provided in such regulations.

The 484,000 gallons of fortified wine deposited with the Fidelity Warehouse Corporation evidenced by the warehouse receipts and stored in the warehouse on January 12, 1934, had been produced by the taxpayer at its Bonded Winery No. 3620 prior to January 11, 1934, and contained 147,927.08 proof gallons of brandy previously withdrawn from a distillery and previously used in the fortification of the wine produced by the taxpayer. Prior to January 11, 1934, and at the time of the withdrawal and use of the brandy in fortifying the wine there had been assessed against the taxpayer a tax of 10 cents per proof gallon as required by the Revenue Act of 1918, as amended. (R. 62.)

On January 12, 1934, the taxpayer had in its Bonded Winery No. 3620, 220,297.34 gallons of fortified wine. This wine had likewise been produced by the taxpayer in its winery and contained 61,863.88 proof gallons of brandy which had also previously been withdrawn from a distillery for the fortification of the wine produced by the taxpayer and upon this brandy taxpayer had been assessed a tax at the rate of 10 cents per proof gallon as required by the Internal Revenue Act of 1918, as amended. The taxpayer made no claim for the abatement or refund of the tax assessed by the Collector of Internal Revenue on this wine, and the taxpayer does not seek to recover that tax in this action. (R. 63.)

Upon receipt of the wine from the taxpayer, the warehouse company placed it in storage tanks located upon the leased premises and caused to be placed upon the tanks in which the wine was stored, stock cards

showing that the wine was warehoused to the Bank, the description of the wine, the date of the warehousing, the negotiable warehouse receipt number issued against the wine and the quantity and quality of the wine stored therein. (R. 63.)

In accordance with the provisions of the Field Warehouse Storage Agreement and in accordance with an understanding between the taxpayer and the Fidelity Warehouse Corporation, the taxpayer was from time to time permitted to have access to the bonded storeroom for the purpose of servicing and caring for the wine during the period the wine was stored in the bonded storeroom. (R. 63-64.)

All the wine except as otherwise specified herein was in the physical possession and under the physical control of the Fidelity Warehouse Corporation and was held by it as a bonded warehouseman in its Public Bonded Storeroom No. 3728 under the laws of California, and the United States, and the rules and regulations of the Treasury Department, including Treasury Decision 19 and the agreements between it and the taxpayer, between the taxpayer and the Bank and between it and the Bank. (R. 64.)

Prior to the actual issuance of the warehouse receipts, the Bank from time to time extended unsecured bank credits to the taxpayer. As wine was produced and delivered by the taxpayer to the warehouse company, the warehouse company issued the warehouse receipts described above covering the wine. These warehouse receipts were delivered to the Bank. At the request of the Bank, the taxpayer executed several

promissory notes payable to the Bank and executed a collateral agreement with the Bank, which provided that in consideration of the financial accommodations given to Mount Tivy Winery by the Bank and as collateral security for the indebtedness of the winery, it would assign to, and deposit with, the Bank all property delivered by it then or later. As to such property, the agreement stated that the Mount Tivy Winery was the owner and that such property was stored, deposited and cared for at the risk of the winery. It was further stated that the Bank was given power to transfer to its own name as pledgee or trustee any certificates of stock, warehouse receipts, etc., which might be deposited with it as security, that it could sell any property so deposited upon default of the winery and that any excess should go to the winery. (R. 64-70.)

The 484,000 gallons of fortified wine thus delivered to the warehouse company for storage in Public Bonded Storeroom No. 3728 by the taxpayer prior to January 11, 1934, were produced and intended for sale and were subsequently sold in the following manner: The taxpayer secured a prospective purchaser for the wine and notified the Bank of the proposed terms of the sale. In the event the purchaser and the terms of sale were satisfactory to the Bank, the sale was consummated with the approval of the Bank upon a cash or credit basis. As a part of the same general sales transaction, the Bank would then execute and deliver to the Fidelity Warehouse Corporation an order for warehouse release covering the wine sold to the purchaser. The warehouse receipts were then either de-

livered to the warehouse company for cancellation or for endorsement thereon of the amount of the wine sold or for the issuance of a new warehouse receipt, negotiable in form, in the name of and to the order of the Bank for the remaining unsold quantity of wine covered by the warehouse receipt and the redelivery to the Bank of the cancelled, endorsed or new receipt or the Bank would deliver both the order for warehouse release and the warehouse receipt to the purchaser or the warehouse company subject to the purchaser's further order or endorsement. Subject to the order of the purchaser, wine sold to it was thereafter prepared for shipment to the purchaser or its order on the warehouse premises by the taxpayer and the warehouse corporation made an entry on Form 702, a report filed monthly with the Collector by the warehouse company, indicating the release of the wine to the taxpayer and the wine was received by the taxpayer for the purposes mentioned for the account of the purchaser and subject to the order of the purchaser. (R. 71-72.)

The warehouse receipts were in the possession and control of the Bank at all times except when surrendered to the warehouse company for the release of wine. None of the receipts were ever endorsed or negotiated by it. Prior to January 12, 1934, the taxpayer had not defaulted upon its notes nor had any of the other conditions set forth in the collateral pledge agreement under which the Bank could properly demand the wine from the warehouseman matured nor had the Bank disposed of them or of the wine under

any of the powers conferred upon it by the collateral pledge agreement. (R. 72.)

The Bank did not pay personal property taxes or any taxes imposed by the Liquor Taxing Act of 1934 upon the wine covered by the warehouse receipts. All taxes on the wine were paid by the taxpayer in accordance with and pursuant to the agreement with the warehouse corporation. (R. 73.)

In accordance with instructions from the Commissioner of Internal Revenue, the Collector sent the taxpayer a circular on January 15, 1934, which referred to the Liquor Taxing Act of 1934, and required it to submit a list of all wines and other spirits on hand, calling special attention to the fact that the winery should list separately all goods not on the premises but held by the taxpayer and stored elsewhere. (R. 73-77.)

The taxpayer sent in an inventory of wine in its possession as producer and held by it for sale in the use or manufacture of articles intended for sale. (R. 77.) This inventory (R. 78-79) showed that the taxpayer held 660,470.97 gallons of wine, containing 194,963.16 proof gallons of brandy upon which a tax was believed to be due of $19,496.32 (R. 80).

On February 10, 1934, the taxpayer paid the Collector of Internal Revenue $2,000 and subsequently wrote the latter a letter in which it stated that the $2,000 represented a tax liability on brandy in fortified wine in the hands of the taxpayer and that the remaining balance of $17,496.32 represented the tax on the brandy in the fortified wine held by the Fidelity Warehouse Company. As to the latter, the taxpayer asserted

that the Fidelity Warehouse Company held full possession and control of the wine and brandy as a bailee or warehouseman for the Bank of America, and so it protested the payment of any tax assessed or levied against the wine or brandy held by the Fidelity Warehouse Corporation. (R. 80.)

On April 11, 1934, the Commissioner of Internal Revenue assessed taxes in the amount of $19,496.32 against the taxpayer and on November 10, 1934, rejected claims in abatement of $17,496.32 in taxes. On August 28, 1935, the taxpayer filed a claim for the refund of $15,419.33, which claim for refund was also rejected. The taxpayer then filed the complaint in this action on July 28, 1938, and thereafter served the United States Attorney on January 30, 1939, and served the Attorney General of the United States on February 28, 1939. The service on the United States Attorney and the Attorney General of the United States were made more than two years after the date of the mailing of the notice of rejection of the claim for refund by the Commissioner of Internal Revenue. (R. 80-81.)

The District Court concluded as a matter of law (1) that while it did not have jurisdiction of the action against the United States, it did have jurisdiction of the action against the defendant John V. Lewis; (2) that Section 10(c) of the Liquor Taxing Act of 1934 levies an excise tax and does not violate Article I, Section 2, Clause 3, or Article I, Section 9, Clause 4 of the Constitution; (3) that such section does not violate the Fifth Amendment to the Constitution; (4) that the

taxpayer was the producer of the 484,000 gallons of fortified wine stored with the Fidelity Warehouse Corporation on January 12, 1934, held such wine within the meaning of Section 10(c) of the Liquor Taxing Act, and also intended to sell such wine within the meaning of that section; (5) that the taxpayer was liable under Section 10(c) for tax in the amount of $14,792.71 on 484,000 gallons of fortified wine, and also liable for $1,558.53 in interest; (6) that the taxpayer is not entitled to recover any sum paid and (7) that John V. Lewis is entitled to a judgment of dismissal with costs. (R. 82-84.)

SUMMARY OF ARGUMENT.

The District Court properly denied any refund here inasmuch as the taxpayer comes within the statutory provision imposing a tax on wine held by the producer and intended for sale or use in the manufacture of any article intended for sale. In common understanding "to hold" means to own property, and the taxpayer was the owner here in the sense that ownership is popularly understood and is interpreted in tax law. It is not material that the wine was not in the physical possession of the taxpayer on the critical date or that negotiable warehouse receipts covering such wine had been issued to a bank. The evidence shows that the receipts were delivered to the Bank pursuant to an agreement which gave the terms of loans made by the Bank to the taxpayer and indicated that such receipts were being transferred as a pledge, not as a result of

a sale to the Bank. Thus, the Bank held the receipts merely as security for these loans and could claim the wine only in case of default, but as there was no default, it never had a right to take the wine from the warehouse. By all of their actions, the parties showed that the taxpayer was considered the real owner, and this should be the view in this case. In administering tax laws, courts have not favored a view of ownership which is highly technical or imposes refinements of title, and the District Court is in accord with such decisions.

The tax here involved does not violate any provision of the Constitution or the amendments thereto. It is not a direct tax on property but is a tax on a particular use of property. Therefore, it is an excise tax specifically authorized by the Constitution and is similar to many others which have been sustained by the courts. Accordingly, there is no basis for the taxpayer's objection that the tax here is invalid.

ARGUMENT.

I.

WINES PRODUCED AND FORTIFIED BY THE TAXPAYER AND STORED IN THE WAREHOUSES WERE HELD AND INTENDED FOR SALE WITHIN THE MEANING OF SECTION 10(c) OF THE LIQUOR TAXING ACT OF 1934 AND ARE SUBJECT TO THE TAX IMPOSED BY THAT SECTION.

On January 12, 1934, the effective date of the Liquor Taxing Act of 1934, the wine in the warehouses had been fortified with brandy upon which there had been

paid or assessed a tax at the rate of ten cents per proof gallon. (R. 24.) See also Section 612 of the Revenue Act of 1918, c. 18, 40 Stat. 1057, as amended by Section 452 of the Revenue Act of 1928, c. 852, 45 Stat. 791. Section 8 of the 1934 Act raised the tax on brandy used in the fortification of wine after January 12, 1934, to twenty cents per proof gallon. Section 10(c), Appendix, *infra*, imposed upon all wines held by the producer on January 12 and intended for sale or for use in the manufacture or production of any article intended for sale a floor stock tax equal to the amount, if any, by which the tax provided for in Section 8 exceeds the tax paid upon the brandy used in the fortification of the wine. The obvious purpose of the statute was to prevent wine stored in bonded storerooms or warehouses throughout the nation from entering the field of commerce at the old tax rate, thus avoiding the increased tax and securing an advantage over wine fortified subsequent to the passage of the 1934 Act.

Clearly, therefore, in referring to wines "held" by the producer on January 12 and intended for sale, Congress had in mind wine which had not been sold or removed from the bonded warehouses for consumption or sale, and the word "held" was not used in any narrow sense. To argue, as does the taxpayer, that the wine here involved was not "held" by it merely because the warehouse had possession of the wine and the Bank had warehouse receipts for the wine is to disregard entirely the purpose of the tax and the nature of the credit transaction with the Bank.

The word "held" is not a word of art and its meaning depends on the statute in which it is used. In this case, however, the word "held" may be given its known and ordinary meaning (*Old Colony R. Co. v. Commissioner,* 284 U.S. 552, 560), and the taxpayer will nevertheless come within the scope of the statute. "To hold" (present tense of "held") is commonly defined as "to maintain possession or authority over" and also as "to own or possess". See Webster's New International Dictionary. From these definitions, it is apparent that holding may refer either to possession or ownership. For instance, an owner turning over his property to a bailee, an agent, or a lessee, but still having control and dominion over the property and also the right to recover possession upon meeting certain conditions is generally considered as still holding the property, regardless of who has actual possession. We make this point because this taxpayer seems to be one of the opinion that even if the Bank were not concerned with the transaction here, the physical possession of the wine by the warehouse company might prevent the imposition of the tax. It is clear that such a construction of the statute is not tenable.

Nor does the dictionary definition suggest that the holding of property depends on the technicalities of title. Moreover, the Supreme Court has said that under common understanding, to hold property means to own it (*McFeely v. Commissioner,* 296 U.S. 102; *Helvering v. Gambrill,* 313 U.S. 11), but it has also said that the taxing statutes are less concerned with refinements of title than they are with the actual command or control

of property. *Corliss v. Bowers,* 281 U.S. 376, 378; *Griffiths v. Commissioner,* 308 U.S. 355, 357.

Taxation is eminently a practical matter and courts look through form to substance in tax cases whether the problem is that of determining property rights or the construction of contracts or other matters. *Tyler v. United States,* 281 U.S. 497; *Commissioner v. Moore,* 48 F. 2d 526, 528 (C.C.A. 10th). That taxation should not be made to depend on the technicalities of conveyancing (*Helvering v. Hallock,* 309 U.S. 106) seems obvious. Moreover, the rule is not novel. It is in line with the policy which courts have long followed in protecting the mortgagor or pledgor and in dealing with them as the true owners, regardless of liens or technicalities of title. Cf. *Helvering v. Hutchings,* 312 U.S. 393, in which it was recognized that where a donor conveys property in trust for the benefit of certain persons, the latter, who have only an equitable interest, and not the trustees, are the donees for tax purposes. Also see *Commissioner v. Nevius,* 76 F. 2d 109 (C.C.A. 2d), certiorari denied, 296 U.S. 591, in which the court, in replying to a question involving equitable interests, said (p. 110):

> Historically it may be accurate to think of equitable interests in property as merely rights in personam against the holder of the legal title. * * * But it is most unlikely that the framers of a tax statute intended to carry any such nice distinctions into their legislation. Equitable interests are so common and so valuable that it is incredible that they should be excluded from taxation. The naked legal title of a trustee during the continuance of the trust has no pecuniary value.

The application of these principles to the facts here involved compels the conclusion that the taxpayer had the substantial rights of ownership of the wine.

The taxpayer here apparently agrees that the word "held" may be used in the sense of ownership in Section 10(c) but asserts that it was not the owner of the wine because negotiable warehouse receipts covering the wine had been issued to a bank from which it had borrowed money. The argument is not entirely clear since the taxpayer seems to assume that the wine was sold to the Bank, but to concede that it nevertheless retained an equitable interest in the wine. But there can be no doubt that the taxpayer's whole argument is based on technicalities of title.

It is obvious, however, that the taxpayer's agreement with the Bank was merely a plan adopted to give credit to the taxpayer. As a producer of wine, the taxpayer wished to offer such wine as security for the money he needed and was able to borrow from the Bank. Since the Government required the taxpayer to store its wine in a bonded warehouse and the Bank would not have been in a position to take the wine anyway, the parties did the only thing which could have been done under the circumstances, and that was to deliver to the Bank the warehouse receipts covering the wine. This was a symbolic delivery of the wine but it was in no sense a sale, as the taxpayer infers. The parties neither treated it as a sale nor intended it to be one. Consequently, although what the parties did in order to afford the taxpayer the desired credit might be construed as affecting a transfer of a qualified legal

title to the bank, nothing was done which requires this Court to hold that the taxpayer was deprived of its ownership of the wine, as that term must be defined here.

The evidence shows that the warehouse which stored the wine here was established by a corporation under special permission granted by the Treasury Department and for the sole purpose of storing the wine which was to be used as the basis for securing credit. (R. 51-53.) When the warehouse receipts were issued, they all called attention to this fact and thus indicated that the delivery to the Bank was for credit purposes. (R. 61.) Moreover, the Bank and the taxpayer executed a collateral agreement in which it was provided that in consideration of advances made or to be made by the Bank, the taxpayer described therein as "the owner", was assigning, transferring and depositing certain property with the Bank *as security for its debts.* (R. 64-65.) This agreement authorized the Bank to sell such property in case of the taxpayer's default or insolvency, or the wine's deterioration in value, but required the Bank to pay any surplus from a sale to the taxpayer. (R. 67-68.) From this it is clear that the warehouse receipts were delivered to the Bank pursuant to such agreement and merely as security. Thus, regardless of what might have happened if the warehouse receipts had been legally transferred to another party by the Bank, it must be admitted that we do not have such a situation here. The Bank never transferred the receipts and since none of the conditions happened which would have permitted the Bank to sell the wine, it was never in a position to demand the wine

or to act on its warehouse receipts. Consequently, the taxpayer remained for all practical purposes as much the owner of the wine as if the warehouse receipts had never been delivered to the Bank. And that was in fact the way the parties treated the taxpayer. The stipulation of facts indicates that after the loans were made and the receipts delivered to the Bank, the taxpayer was permitted by the Warehouse Company to have access to the bonded storeroom "for the purpose of servicing and caring for said wine". (R. 29, 64.) If the taxpayer had sold the wine to the Bank, or no longer had an interest in it, it would not have had, of course, any reason to look after the wine.

The stipulation shows further that it was the taxpayer who secured the purchasers of the wine and actually prepared the wine for shipment after approval of the proposed purchaser had been given by the Bank. (R. 25-26, 71-72.) And it was the taxpayer who made the reports to the Government as to the wine. (R. 26, 72.) Furthermore, while the taxpayer asserts that the Bank owned the wine, it stipulated that the Bank did not pay any personal property taxes thereon. (R. 29, 73.)

We submit that these facts clearly show that as between the taxpayer and the Bank, the former was the owner of the wine, and there are no other parties concerned with it (except the warehouse company which could not possibly qualify as owner under the facts here). Thus, we must conclude that the taxpayer held the wine as required by the statute. As we have indicated, it is not necessary to speculate what the situa-

tion might have been with different facts. We are required to consider only the facts which are before us. Moreover, it may not be necessary to determine what the transaction between the Bank and the taxpayer should be called inasmuch as the collateral agreement did not intend the transfer of the receipts to constitute a sale, and for tax purposes the taxpayer was the owner. However, as the taxpayer's brief considers the legal implications of the transaction at length, we will also discuss the point.

It is our position that the taxpayer pledged the warehouse receipts to the Bank because in California (1) a pledge is a deposit of personal property *by way of security* for the performance of another act, and (2) every contract made in California by which possession of personal property is transferred *as security only* is deemed to be a pledge. Sections 2986 and 2987, Deering's Civil Code of California (1931), Appendix, *infra*. It is, of course, true in California, as well as generally, that while a pledger surrenders possession of the pledged property to the pledgee or a pledge holder, such as the warehouse company, he does not usually give up his legal title. Obviously when something negotiable is pledged, such as the warehouse receipts here, and title goes with the physical delivery of such receipts, the owner parts with his legal title until his debt is paid, but so far as the pledgee-creditor is concerned, such transfer is subject to the terms of their agreement.[5] And the possession of a warehouse

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[5]The correctness of our contention is shown by the California statute covering warehouse receipts, particularly Section 42, Title

receipt is not conclusive proof as it is only prima facie evidence of ownership. *Akron Cereal Co. v. First Nat. Bank*, 3 Cal. App. 198, 201.

Moreover, while legal title apparently passed to the Bank for the limited purpose indicated, there is nothing in the Warehouse Receipts Act of California discussed in the taxpayer's brief (pp. 40-41), which is in conflict with the view that the receipts here were merely pledged and that the taxpayer remained the owner of the wine for all practical purposes. This being so, there is nothing in the California law which would prevent due effect being given to the agreement as executed by the Bank and the taxpayer. The plan followed by the parties is one which has long been known and approved in business circles, and there is no doubt that transactions like the one here are treated as pledges. To this effect, see *Dale v. Patison*, 234 U.S. 399; *Union Trust Co. v. Wilson*, 198 U.S. 530; *Taney v. Penn Bank*, 232 U.S. 174, 184; *McCaffey C. Co. v. Bank of America*, 109 Cal. App. 415, 428.

Even the case of *Heffron v. Bank of America Nat. Trust & Savings Ass'n*, 113 F. 2d 239 (C.C.A. 9th), cited by the taxpayer (Br. 50-52), is in accord with this view. There the question was whether upon the bankruptcy of the debtor-pledgor, the Bank which held

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633, Deering's General Laws of California (1931), which provides in part as follows (p. 4984):

> § 42. What is acquired by transfer of receipt. A person to whom a receipt has been transferred but not negotiated acquires thereby as against the transferor, the title to the goods, *subject to the terms of any agreement with the transferor.* [Italics supplied.]
>
> * * *

the warehouse receipts as pledgee had a valid lien in view of the fact that there was failure to meet certain requirements of the California Bulk Sales Act. This Court held that the Bank had a valid lien and that a portion of the latter act had been repealed. However, in reaching its decision, this Court recognized the right of a person in the position of the taxpayer here to pledge warehouse receipts, for it stated (p. 242):

> The right is unconditionally bestowed on the owner of warehoused goods to convey *or pledge his title* by a transfer of the warehouse receipt. * * * [Italics supplied.]

Obviously, when an owner pledges, rather than conveys, his property, he is not required by the well established principles governing pledges to part completely with his interest in the property but is merely required to give the creditor-pledgee certain rights pending the time the debt is unpaid, and when the debt is paid they are restored to the pledgor.

Thus, we submit that the Bank here was merely a pledgee and not the owner, and we find support for such view, not only in cases already referred to, but also in the California Warehouse Receipts Act on which the taxpayer places so much reliance. That act, in Section 58, Title 633, Deering's General Laws of California (1931), in defining various terms states that an " 'Owner' does not include mortgagee or pledgee". Thus, under that act the Bank here, being a pledgee, would not be treated as the owner. In this connection it should be noted that in the collateral agreement with the Bank, the taxpayer waived the provision of Sec-

tion 3006 of the Civil Code of California. (R. 68.) Section 3006 (Appendix, *infra*) refers only to pledgees and prohibits sales of pledged property by a pledgee except as to certain named obligations. We think the taxpayer's waiver of this provision is significant since it indicates that the parties themselves considered the Bank to be merely a pledgee, but by the waiver the Bank was given the right to sell. However, such right was permitted only to the extent indicated in the agreement. Consequently, in legal effect the Bank got a qualified, not an absolute title to the wine. To this effect, see *Douglass v. Wolcott Storage & Ice Co.*, 251 App. Div. 79; *Driggs v. Dean,* 167 N.Y. 121; *Millichamp v. First Nat. Bank of Toppenish,* 130 Wash. 175. These cases involve warehouse statutes similar to the one in California and are in accord with our view here.

The taxpayer's argument that it could not set up its own title "to defeat the pledge of the property by the warehouse company to the Bank" (Br. 42) is untenable, because if either the Bank or the warehouseman should refuse to deliver the liquor to the taxpayer after it had carried out its contractual obligations, it could have filed suit to assert its title and recover its pledged property. Section 3008, Civil Code of California, Appendix, *infra*; *Bell v. Bank of California,* 153 Cal. 234.

In its effort to show that it does not come within the terms of the revenue statute here, the taxpayer has cited many cases and authorities (Br. 27-54), but we have found none of them which support its contention

that it did not hold the wine on January 12, 1934, because it was not then the owner within the meaning of the statute. Of the numerous cases cited, the one which appears to present a situation most nearly like the one here is *Earle C. Anthony (Inc.) v. United States,* 57 C. Cls. 259. That case arose under a revenue statute imposing a tax on various articles, including automobiles, "held and intended for sale", but the question there was whether an automobile which had been sold by the taxpayer, a dealer, under a conditional sale contract was still "held and intended for sale" because the taxpayer could recover it from the purchaser in case the latter defaulted on his payments. The court correctly decided that the automobile was no longer held by the taxpayer because the latter intended to make a sale when the contract was executed and the car was delivered to the purchaser. Under such circumstances, the court held that the reservation of title did not prevent its holding that a sale had been made before the critical date of the statute. We submit that this case actually supports our contention in that it shows that the person having legal title may not actually be the "holder" or actual owner of the property. Instead, the real owner there, as well as here, was the one who had an equitable interest and was in a position to acquire legal title under the conditions of the agreement.

II.

THE TAX IMPOSED HERE DOES NOT VIOLATE ANY PROVISION OF THE CONSTITUTION AND IS A VALID EXCISE TAX.

The taxpayer also contends that even if it does come within the provisions of Section 10(c) of the Liquor Taxing Act, such tax is invalid for the reasons that (1) it is a direct tax upon property and is in violation of Section 9, Clause 4 of Article I of the Constitution (Appendix, *infra*) in that it is not in proportion to the census; (2) it is not apportioned among the several states and so violates Section 2, Clause 3 of Article I of the Constitution (Appendix, *infra*); and (3) it imposes a tax upon one class of persons only and constitutes a violation of the Fifth Amendment (Appendix, *infra*).

The District Court overruled these objections and in doing so pointed out that the presumption in favor of the constitutionality of a statute is strong, and that the taxpayer had failed to sustain its burden of showing that the statute is invalid. We submit that the District Court's decision is in accord with many decisions.

Article I, Section 8, Clause 1 of the Constitution gives Congress the power "To lay and collect Taxes, Duties, Imposts and Excises" (Appendix, *infra*). All such taxes, etc., must be uniform throughout the United States, but such uniformity is geographic, not intrinsic. *Bromley v. McCaughn,* 280 U.S. 124; *Knowlton v. Moore,* 178 U.S. 41. The tax here applied to all wine producers in the United States on January 12, 1934, holding wine intended for sale or use in the

manufacture of articles intended for sale. Thus, there is no real foundation for the taxpayer's contention here that this tax lacks the uniformity required by Article I, Section 2, Clause 3 of the Constitution.

We also submit that this tax is not a direct tax. It is, of course, now settled that taxes levied upon, or collected from, persons because of their general ownership of property are direct and so must be in proportion to the census, as the Constitution requires. *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429, 158 U.S. 601. But the Supreme Court has consistently held almost from the foundation of the Government, that a tax imposed upon a particular use of property or exercise of a single power over property incidental to ownership is an excise, or indirect, tax which need not be apportioned. *Bromley v. McCaughn, supra,* p. 136. The following have been sustained as indirect taxes: Taxes on particular types of sales (*Nicol v. Ames,* 173 U.S. 509; *Thomas v. United States,* 192 U.S. 363); upon the use of carriages for the conveyance of persons (*Hylton v. United States,* 3 Dall. 171); upon the amount of notes paid out by any state bank (*Veazie Bank v. Fenno,* 8 Wall. 533); upon manufactured tobacco, having reference to its origin and intended use (*Patton v. Brady, Executrix,* 184 U.S. 608); upon the manufacture and sale of colored oleomargarine (*McCray v. United States,* 195 U.S. 27); a succession tax upon the devolution of title to real estate (*Scholey v. Rew,* 23 Wall. 331); a tax on legacies (*Knowlton v. Moore, supra*); and taxes on doing business by particular methods (*Flint v. Stone Tracy Co.,* 220 U.S. 107;

Spreckels Sugar Refining Co. v. McClain, 192 U.S. 397).

The tax here is laid upon the exercise of a single power incident to ownership, namely, the power of an owner, who is a wine producer, to hold such wine for sale or for use in the manufacture of articles intended for sale. Consequently, this tax is an excise tax[6] and falls in the same class as the cases just cited. And this was the holding in *Commonwealth of Pennsylvania v. Fix,* 9 F. Supp. 272 (M.D. Pa.), affirmed *sub nom. Commonwealth of Pennsylvania ex rel Margiotti v. Kyle,* 79 F. 2d 520 (C.C.A. 3d), certiorari denied, 297 U.S. 704. The taxpayer seeks to discount the decision in that case by stating that the District Court's decision is "at best poor dictum" (Br. 66), but it will be seen from the District Court's opinion that (1) the same statutory provision involved here was construed in that case; (2) the State of Pennsylvania, in seeking to avoid paying tax on liquor held by it, raised the same constitutional questions; and (3) the District Court held that the tax imposed in this statute is an excise tax, not a direct tax, and need not be apportioned. We submit that this is a direct ruling in favor of the Government on our questions here, and this case was affirmed on appeal.

Furthermore, as was pointed out in the *Fix* case, the statutory provision imposing the tax here is very similar to that involved in *Patton v. Brady, supra.* That case arose under Section 3 of the Act of June 13, 1898, to provide ways and means to meet the expenditures

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[6]See definition in *Knowlton v. Moore, supra* (p. 88).

of the Spanish-American War. Section 3 first provides, in lieu of the tax then imposed, another tax upon all tobacco and snuff however prepared, manufactured and sold for consumption or sale. It provides further for an additional tax, as in the statute here, on such articles then "held and intended for sale".[7] It will be seen that there is in fact no material difference in the two statutes, and the Supreme Court upheld this additional tobacco tax as a valid excise tax.

We submit that the same conclusion should be reached here. The taxpayer also refers to the Fifth Amendment (Br. 56), but merely states, without discussion, that this tax violates the due process clause. It is, of course, well established that the Fifth Amendment is not a general limitation on the taxing power of the Federal Government (*Brushaber v. Union Pac. R. R.,* 240 U.S. 1), and since there is nothing arbitrary or capricious about the imposition of this tax, the objection is without substance.

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[7]The provision imposing such additional tax reads as follows (c. 448, 30 Stat. 448, 450):

> And there shall also be assessed and collected with the exceptions hereinafter in this section provided for, upon all the articles enumerated in this section which were manufactured, imported, and removed from factory or custom-house before the passage of this Act bearing tax stamps affixed to such articles for the payment of the taxes thereon, and canceled subsequent to April fourteenth, eighteen hundred and ninety-eight, and *which articles were at the time of the passage of this Act held and intended for sale by any person,* a tax equal to one-half the difference between the tax already paid on such articles at the time of removal from the factory or custom-house and the tax levied in this Act upon such articles. [Italics supplied.]

* * *

As in this case, the taxpayer in *Patton v. Brady, Executrix, supra,* protested on the ground that this additional tax was not a valid excise tax, but the Court overruled its objections.

CONCLUSION.

The decision of the District Court is correct and should be affirmed.

Dated, November 18, 1942.

Respectfully submitted,

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(Appendix Follows.)

Appendix.

Appendix

Liquor Taxing Act of 1934, c. 1, 48 Stat. 313:

SECTION 1. This Act may be cited as the "Liquor Taxing Act of 1934".

*   *   *   *   *

SEC. 8. Section 612 of the Revenue Act of 1918, as amended (relating to the tax on grape brandy and wine spirits withdrawn and used in the fortification of wines) [U.S.C., Sup. VI, title 26, sec. 1301], is amended by striking out "10 cents per proof gallon" and inserting in lieu thereof "20 cents per proof gallon".

*   *   *   *   *

SEC. 10. (a) Upon all distilled spirits produced in or imported into the United States upon which the internal-revenue tax imposed by law has been paid, and which, on the day this title takes effect, are held by any person and intended for sale or for use in the manufacture or production of any article intended for sale, there shall be levied, assessed, collected, and paid a floor tax equal to the amount if any, by which the tax provided for under this title exceeds the tax so paid, not including in the computation of the tax so paid the 30 cent tax imposed by section 605 of the Revenue Act of 1918.

*   *   *   *   *

(c) Upon all wines held by the producer thereof upon the day this title takes effect and intended for sale or for use in the manufacture or production of any article intended for sale, there shall be levied, assessed, collected, and paid a floor tax equal to the amount, if any, by which the tax provided for under section 8 of this title exceeds

the tax paid upon the grape brandy or wine spirits used in the fortification of such wine.

* * * * *

SEC. 13. This title shall take effect on the day following its enactment.

Constitution of the United States:

Article. I.

* * * * *

Section. 2. * * *

Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, * * *

Section. 8. The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, * * *

Section. 9. * * *

No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.

AMENDMENT 5.

No person shall be * * * deprived of life, liberty, or property, without due process of law: * * *

Deering's Civil Code of California (1931), c. III:

SEC. 2986. *Pledge, what.* Pledge is a deposit of personal property by way of security for the performance of another act.

SEC. 2987. *When contract is to be deemed a pledge.* Every contract by which the possession of personal property is transferred, as security only, is to be deemed a pledge.

SEC. 2988. *Delivery essential to validity of pledge.* The lien of a pledge is dependent on possession, and no pledge is valid until the property pledged is delivered to the pledgee, or to a pledge-holder, as hereafter prescribed.

* * * * *

SEC. 2991. *Real owner cannot defeat pledge of property transferred to apparent owner for the purpose of pledge.* One who has allowed another to assume the apparent ownership of property for the purpose of making any transfer of it, cannot set up his own title, to defeat a pledge of the property, made by the other, to a pledgee who received the property in good faith, in the ordinary course of business, and for value.

* * * * *

SEC. 2993. *Pledge-holder, what.* A pledgor and pledgee may agree upon a third person with whom to deposit the property pledged, who, if he accepts the deposit, is called a pledge-holder.

* * * * *

SEC. 3000. *When pledgee may sell.* When performance of the act for which a pledge is given is due, in whole or in part, the pledgee may collect what is due to him by a sale of property pledged, subject to the rules and exceptions hereinafter prescribed.

* * * * *

SEC. 3001. *Sale of pledged property.* Before property pledged can be sold, and after performance of the act for which it is security is due, the pledge, must demand performance thereof from the debtor, if the debtor can be found.

* * * * *

SEC. 3006. *Pledgee's sale of securities.* A pledgee cannot sell any evidence of debt pledged to him, except the obligations of governments, states, or corporations; but he may collect the same when due.

*   *   *   *   *

SEC. 3008. *Surplus to be paid to pledgor.* After a pledgee has lawfully sold property pledged, or otherwise collected its proceeds, he may deduct therefrom the amount due under the principal obligation, and the necessary expenses of sale and collection, and must pay the surplus to the pledgor, on demand.